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INFO RUEHBM/AMEMBASSY BUCHAREST 4273
RUEHKV/AMEMBASSY KYIV 0585
RUEHMO/AMEMBASSY MOSCOW 3260

UNCLAS CHISINAU 000113

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STATE FOR EUR/UMB

E.O. 12958: N/A
TAGS: ECON EFIN PGOV MD
SUBJECT: MOLDOVA'S ECONOMY RESILIENT IN 2007

¶1. (SBU) SUMMARY: Moldova's economy remained resilient in 2007, overcoming the negative impacts of Russian trade bans, higher tariffs for natural gas and a devastating drought. Although GDP growth was less than forecast (below 4 percent) and inflation was higher than projected (13.1 percent), foreign direct investment (FDI) increased dramatically, reaching USD 450 million. The trade deficit widened as higher priced imports out-paced exports; however, export performance was encouraging with a shift towards the EU. The declining USD, strong remittances and record FDI pushed the Moldovan lei upward, requiring the active intervention of the National Bank. Government finances remained healthy (under the watchful eye of the IMF), and positive signs indicate that the pattern of growth is shifting from consumption-based to investment-driven. END SUMMARY.

MOLDOVA'S ECONOMIC PERFORMANCE

¶2. (SBU) According to preliminary calculations, Moldova's GDP growth is expected to be less than four percent for 2007. Although growth in the first half of the year was eight percent, a record drought, which had a negative impact on the agricultural sector, slowed growth in the second half. Agricultural production (Jan-Sep) declined 21 percent compared with 2006. Industrial production fell 2.7 percent, totaling MDL 26.18 billion (about USD 2.32 billion). Production declined for sugar processing (-50.4 percent), wine (-29.5 percent), alcoholic beverages (-22 percent) and tobacco products (-7.4 percent). However, production of some food and non-food items (canned meat and vegetables, medical equipment and cement) increased.

HIGH INFLATION REMAINS A CONCERN

¶3. (U) According to the National Bureau of Statistics (NBS), inflation (consumer price index) was 13.1 percent in 2007, down from 14.1 percent in 2006. Prices for foodstuffs rose 15.4 percent; non-food prices increased 11.6 percent; and tariffs on services climbed 13 percent. The CPI increase exceeded the IMF and Moldova government's (GOM) projections of 10 percent for 2007.

REMITTANCES AND CURRENCY APPRECIATION

¶4. (U) According to the National Bank of Moldova (NBM), Moldova's foreign reserves grew 72 percent in 2007, reaching a record level of USD 1.33 billion. This growth resulted from the NBM's fight against excess liquidity on the market caused by large inflows of remittances and investments. These inflows coupled with the declining USD put upward pressure on the Moldovan lei (MDL), which appreciated 12.3 percent against the USD in 2007. (NOTE: On January 1, 2007, one USD equaled MDL 12.90. By December 31, it had fallen

to MDL 11.31. END NOTE.) Remittances (Jan-Sep) were estimated at almost USD 1.1 billion and FDI (Jan-Sep) was estimated at USD 450 million.

GOVERNMENT FINANCES REMAIN STRONG

¶5. (U) According to the Ministry of Finance, Moldova's budget revenues totaled USD 1.235 billion in 2007, increasing by USD 251 million or 25.5 percent from the previous year. Revenues were driven by VAT and excises on imports, with the Moldovan Customs Service reporting a 22 percent increase in revenue. Moldova recorded a budget surplus the past four years because of strong revenues from VAT and excises on imports and controlled government expenditures. Budget spending increased 28.3 percent compared with 2006, reaching USD 1.251 billion.

TRADE INCREASES, BUT DEFICT WIDENS

¶6. (SBU) Moldova's trade deficit grew 44 percent in the first 11 months of 2007, reaching USD 2.06 billion, as imports grew faster than exports, according to the NBS. Exports through November rose 30.5 percent (compared with 2006) to USD 1.2 billion; however, imports were 38.5 percent higher, totaling USD 3.3 billion. Over half of Moldova's exports went to the EU, including Romania (16 percent) and Italy (12 percent). The Ministry of Economy commented positively that this shift indicated that Moldovan-made goods were becoming increasingly more competitive and that EU trade preferences offered Moldovan producers new opportunities. Trade with Russia totaled over USD 1 billion, a 40 percent increase over 2006 (mostly a result of higher prices for Russian natural gas). After a two-year absence, Moldovan agricultural products and wine enjoyed a limited returned to the Russian market throughout 2007.

IMF: MOLDOVA'S MACROECONOMIC POLICIES ARE SOUND
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¶7. (SBU) An IMF assessment mission at the end of 2007 concluded that Moldova's economy was doing well, having overcome external shocks with strong prospects for economic growth. The IMF concluded that Moldova's 2008 budget was prudent - given economic and political conditions - and that the NBM had moved quickly to control inflation following the drought. The IMF noted that Moldova's pattern of growth was changing, with encouraging signs that growth was shifting from consumption-driven to investment-driven. The IMF also noted a shift of production and employment into manufacturing (textiles), where Moldova's low labor costs provide a comparative advantage. Despite the positive assessment, the IMF reaffirmed the need for continued structural reforms, particularly regulatory reform, judicial reforms, improved business legislation, simplified licensing procedures and modernized tax administration.

COMMENT

¶8. (SBU) Moldova's economy performed well in 2007 despite a record drought which cut agricultural production. Increases in FDI were impressive and remittances are flowing into investments, which are driving growth. However, much remains to be done to improve Moldova's business environment and competitiveness. As the IMF noted, the structural reform agenda remains long. Regardless of the current business environment, Moldova seems to be enjoying the much talked about "spill-over" effect from Romania's accession to the EU. This, coupled with new EU trade preferences, will continue to attract FDI to Moldova and drive economic growth. END COMMENT.

KEIDERLING